89 No. 1046



IN THE

# Supreme Court of the United States

OCTOBER TERM, 1989

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JOSEPH A. FRATES, CHARLES S. HOLMES, ROBERT E. MERRICK, STAN P. DOYLE, P. PETER PRUDDEN, III, J. ANTHONY FRATES, STEPHEN I. FRATES, EQUIVEST ASSOCIATES, DOYLE & HOLMES, EQUIVEST MANAGEMENT AND FINANCIAL SERVICES, LTD., JOHN L. FARRELL, JR., ASSET MANAGEMENT, INC., MONTY H. RIAL, PERMA RESOURCES CORPORATION, PERMA MINING CORPORATION, PERMA PACIFIC, INC., CALDER & COMPANY, CHIMNEY ROCK COAL COMPANY, ENERGY CAPITAL, LTD., AZTEC, LTD., COLORADO COAL RESOURCES COMPANY AND COLORADO COAL MINING,

*Petitioners,*

v.

HONORABLE ZITA L. WEINSHIENK, UNITED STATES DISTRICT JUDGE, HONORABLE CHARLES E. MATHESON, UNITED STATES BANKRUPTCY JUDGE, KAISER STEEL CORPORATION AND KAISER COAL CORPORATION,

*Respondents.*

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## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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## QUESTIONS PRESENTED

1. In determining whether a bankruptcy judge's "impartiality might reasonably be questioned" under 28 U.S.C. §455(a) because the bankruptcy judge continued to preside over adversary proceedings after having approved a plan of reorganization which depends upon successful prosecution of the adversary proceedings, may an appellate court refuse to assess an appearance of partiality from the viewpoint of a reasonable person, and instead adopt a technical and legalistic test "whether the judge appears to have prejudged adversarial proceedings or to have placed himself in a position where it appears he will be forced to decide one or more of the adversary proceedings in [the debtor's] favor"?

2. Under 28 U.S.C. §455(a), may an appellate court refuse to consider the facts as they existed at the time the recusal motion was made, and instead consider facts arising after the motion for recusal was denied?

3. May an appellate court allow a bankruptcy judge, who has approved a plan for reorganization of a Chapter 11 debtor, to deny recusal in related adversary proceedings commenced by the debtor, where the only source of funds to pay the accrued costs and expenses of the reorganization is recovery from the adversary proceedings?

## PARTIES

All parties in interest are named in the caption. Equivest Management and Financial Services, Ltd. and Asset Management, Inc. have no parent or subsidiary corporations. Pursuant to Rule 12.4, Petitioners hereby notify the Clerk of this Court of their belief that Charles S. McNeil, a party to the proceeding below, has no interest in the outcome of the petition for the reason that Mr. McNeil has reached a settlement of the underlying adversary proceedings.

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IN THE

# Supreme Court of the United States

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HONORABLE ZITA L. WEINSHIENK, UNITED STATES DISTRICT JUDGE, HONORABLE CHARLES E. MATHESON, UNITED STATES BANKRUPTCY JUDGE, KAISER STEEL CORPORATION AND KAISER COAL CORPORATION,

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## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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Petitioners respectfully request that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

## OPINIONS BELOW

The order of the United States Court of Appeals for the Tenth Circuit denying rehearing is reprinted in the appendix to this petition at Pet. App. 1a-2a. The opinion of the Tenth Circuit denying mandamus is reported at 882 F.2d 1502 and is reprinted at Pet. App. 3a-11a. The unreported opinion of the United States District Court for the District of Colorado is reprinted at Pet. App. 12a-13a. The transcript from the bench ruling of the United States Bankruptcy Court for the District of Colorado is reprinted at Pet. App. 14a-21a.

## JURISDICTION

The judgment of the court of appeals was entered on August 16, 1989. A Petition for Rehearing before the panel and a Suggestion for Rehearing *en banc* was denied on October 5, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

## STATUTE INVOLVED

The statutory provision involved herein is 28 U.S.C. §455(a), which provides as follows:

> Any justice, judge or magistrate of the United States shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned.

## STATEMENT OF THE CASE

These proceedings arise out of the Chapter 11 bankruptcy of Kaiser Steel Corporation ("Kaiser"), which was filed by Kaiser in February 1987. Kaiser's bankruptcy was preceded by a leveraged buyout ("LBO")

of Kaiser which closed in February 1984. The alleged failure of the Kaiser LBO and the nationwide fraudulent conveyance litigation it spawned present important issues regarding the administration of justice in the bankruptcy courts.

Immediately after filing its Chapter 11 petition, Kaiser commenced five adversary proceedings in the bankruptcy court, all of which arise out of the Kaiser LBO. Only two of these adversary proceedings had been actively pursued by Kaiser when Petitioners moved for recusal of the bankruptcy judge in November, 1988: *Kaiser Steel Corp., et al. v. Joseph A. Frates, et al.*, Adversary Proceeding No. 87-E-135 (Bankr. D. Colo.), and *Kaiser Steel Corp., et al. v. Monty H. Rial, et al.*, Adversary Proceeding No. 87-E-437 (Bankr. D. Colo.) (the "Adversary Proceedings"). Petitioners, who had participated as investors in the LBO, are defendants in both Adversary Proceedings. Kaiser seeks damages in the Adversary Proceedings in excess of $100 million.

On October 4, 1988, Chief Bankruptcy Judge Charles E. Matheson approved Kaiser's Plan of Reorganization, which depended on recoveries from the Adversary Proceedings for the payment of administrative expenses and for distributions to unsecured creditors. As part of the reorganization plan, Bankruptcy Judge Matheson entered an order allowing Kaiser to borrow $4 million for the sole purpose of funding the Adversary Proceedings and other litigation related to the LBO.

Petitioners, among others, filed their motion under 28 U.S.C. §455(a) for recusal of Bankruptcy Judge Matheson from the Adversary Proceedings on November 4, 1988, one month after he had approved

Kaiser's Plan of Reorganization. Petitioners requested the bankruptcy judge to recuse himself on the grounds that his impartiality might reasonably be questioned if he continued to preside over the Adversary Proceedings after having approved a reorganization plan which depended for its success on recovery from those proceedings.

In support of their motion, Petitioners cited the admission by Kaiser that the reorganization plan depended on successful prosecution of the Adversary Proceedings. Bruce E. Hendry, who served as Kaiser's Chairman and Chief Executive Officer during the Chapter 11 proceeding, testified as follows:

> Question: [I]sn't it a fact, Mr. Hendry, that if these lawsuits are not successful, the unsecured creditors will not receive—are not likely to receive any cash distributions as a result of the reorganization?
>
> Mr. Hendry: That's correct.
>
> Question: And isn't it also a fact that these lawsuits need to be successfully prosecuted in order for Kaiser to be able to pay its administrative expenses as a result of the reorganization?
>
> Mr. Hendry: Yes. In order to pay those fees, we have to have a successful litigation effort, that's correct.

Pet. App. 24a-27a. Public information subsequently released by Kaiser confirmed Mr. Hendry's testimony. Pet. App. 35a-41a.

As a legal basis for their recusal motion, Petitioners relied on this Court's decision in *Liljeberg v. Health Services Acquisition Corp.*, 486 U.S. 847, 108 S.Ct. 2194 (1988) ("*Liljeberg*"), which establishes the "reasonable person" test for assessing the appearance of partiality under 28 U.S.C. §455(a). Petitioners also relied on the Tenth Circuit decisions in *United Family Life Insurance Co. v. Barrow*, 452 F.2d 997 (1971) ("*Barrow*") and *American Employers' Insurance Co. v. King Resources Co.*, 545 F.2d 1265 (1976) ("*King Resources*"), which establish that a judge who presides over a debtor's reorganization cannot also adjudicate litigation on which the reorganization depends. The principles laid down in these cases assure both the fact and appearance of impartiality in the bankruptcy courts, and they have assumed increasing importance as highly leveraged corporate transactions of the 1980's have reached the bankruptcy courts.

On December 16, 1988, Bankruptcy Judge Matheson denied all motions for recusal without reference to the *Liljeberg* decision. The bankruptcy judge concluded that the Tenth Circuit law contained in *Barrow* and *King Resources* no longer applied to cases filed after the Bankruptcy Reform Act of 1978, 11 U.S.C. §§101-151326. Pet. App. 14a-21a. Despite a specific request from Petitioners' counsel, the bankruptcy judge declined to make any finding as to whether there was an appearance of partiality. Pet. App. 19a-21a. Following denial of the motion for recusal, some of the defendants in the Adversary Proceedings entered into settlements with Kaiser in order to avoid trial before Bankruptcy Judge Matheson.

On January 6, 1989, pursuant to 28 U.S.C. §158(a) and Bankruptcy Rule 8001(b), Petitioners filed with

the bankruptcy court their motions for certification, notices of appeal and motions for leave to appeal from Bankruptcy Judge Matheson's denial of the recusal motions. Because of the conflicting decisions among the courts as to the proper procedure by which to obtain immediate review of an order denying a motion for recusal,[1] on January 13, 1989, pursuant to 28 U.S.C. §1651, Petitioners also filed a petition for writ of mandamus with the district court on the recusal issue. On February 13, 1989, District Judge Weinshienk entered orders denying Petitioners' motion for certification, motion for leave to appeal and mandamus petition. Finding only "no error" in the decisions below, Judge Weinshienk provided no opinion to explain her orders. Pet. App. 12a-13a.

On February 21, 1989, pursuant to Rule 21 of the Federal Rules of Appellate Procedure and 28 U.S.C. §1651, Petitioners filed their petition for writ of mandamus with the Court of Appelas for the Tenth Circuit. The mandamus petition cited the failure of the bankruptcy court to follow *Liljeberg* or to apply the Tenth Circuit precedents in *Barrow* and *King Resources*. Oral argument was held on May 11, 1989, and the Tenth Circuit Panel issued its opinion denying mandamus on August 16, 1989.

The Panel opinion made no attempt to apply the *Liljeberg* "reasonable person" test for the appearance of partiality. Instead, the Panel applied its own le-

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[1] *Compare, e.g., In re Cash Currency Exchange, Inc.*, 85 B.R. 797 (N.D. Ill. 1988) (writ of mandamus is only remedy for review of denial of a motion to recuse under 28 U.S.C. §455(a)) with *In re Johns-Manville Corp.*, 43 B.R. 765 (S.D.N.Y. 1984) (motion for leave to appeal pursuant to B.R. 8003 is proper procedure for seeking review of denial of motion to recuse).

galistic test and determined that recusal is necessary only where there is evidence of actual bias or an appearance that the bankruptcy judge has "prejudged" adversarial proceedings or been "boxed in" by prior rulings such that he will be forced to reach a certain result in an adversarial proceeding regardless of the merits. Pet. App. 5a-6a. While ruling that *Barrow* and *King Resources* were applicable, the Panel failed to apply the principles of those cases in accordance with the test required by *Liljeberg*.

Rather than considering the facts as they appeared at the time the recusal motion was made, the Panel concluded that the Kaiser reorganization did not depend on success in the Adversary Proceedings, curiously relying on the payment of accrued administrative and reorganization expenses from settlements in the Adversary Proceedings entered into after the denial of recusal. Pet. App. 8a. Thus, the Panel, with questionable use of hindsight analysis, upheld Bankruptcy Judge Matheson without any analysis of the facts as they existed at the time the Motion for Recusal was filed.

Petitioners filed their petition for rehearing and suggestion for rehearing *en banc* on August 30, 1989. The Tenth Circuit issued its order denying rehearing on October 5, 1989.

## REASONS FOR GRANTING THE WRIT

The Court should grant certiorari in this case because the opinion of the Tenth Circuit conflicts with *Liljeberg* and with opinions of other circuit courts of appeals. In addition, the unsettled issues presented here regarding judicial conflicts in reorganization cases are important to the administration of justice

in federal bankruptcy matters and should be clarified by this Court.

## I. THE TENTH CIRCUIT'S OPINION CONFLICTS WITH *LILJEBERG.*

The opinion of the Tenth Circuit conflicts with *Liljeberg* by failing to apply a reasonable person standard for the appearance of partiality. Instead, the Tenth Circuit applied its own legalistic test, requiring "prejudgment" or prior decisions which "boxed in" the bankruptcy judge. The Tenth Circuit fell into further conflict with *Liljeberg* by considering the facts as they existed at the time of appeal instead of the time recusal was sought.

### A. The Tenth Circuit Test Is Contrary to the *Liljeberg* Reasonable Person Test.

The proper test to determine whether recusal is required under §455(a) is whether a reasonable person, knowing all of the relevant facts, would harbor doubts about the judge's impartiality. *Liljeberg, supra*, 108 S.Ct. at 2202; *Potashnick v. Port City Construction Co.*, 609 F.2d 1101 (5th Cir.), *cert. denied*, 449 U.S. 820 (1980); *In re Manoa Finance Co.*, 781 F.2d 1370 (9th Cir. 1986), *cert. denied*, 479 U.S. 1064 (1987). In its opinion, the Tenth Circuit did not refer to, or even purport to apply, the "reasonable person" test. Instead, the Tenth Circuit created its own legalistic test requiring analysis from the perspective of one intimately familiar with the intricacies of bankruptcy practice:

> [R]ecusal is necessary if there is evidence of actual bias, if the bankruptcy judge by words or actions reasonably appears to have prejudged adversarial proceedings over which he

> is to preside, or if the judge appears 'boxed in' by prior rulings such that he will be forced to reach a certain result in an adversarial proceeding regardless of the merits.

Pet. App. 5a-6a. The Tenth Circuit cited no authority for this rule.

A reasonable person plays no part in the Tenth Circuit's analysis. The only person with the ability to apply the Tenth Circuit test would be a lawyer or businessman with expertise in bankruptcy, and only then after a thorough review of the thousands of pleadings that have been filed in the Kaiser Chapter 11 case and the Adversary Proceedings.

The test applied by the Tenth Circuit flies squarely in the face of the standard set out in *Liljeberg* and ignores the important differences between §455(a) and §455(b). The goal of §455(a) is to avoid even the appearance of partiality, as determined by a "reasonable person." *Liljeberg, supra*, 108 S.Ct. at 2022. Although it purported to apply §455(a), the Tenth Circuit neither cited *Liljeberg* nor analyzed whether a reasonable person with knowledge of all the circumstances might question Bankruptcy Judge Matheson's impartiality. Instead, the Tenth Circuit began its analysis by stating that, because there was no claim of actual bias, the "prejudgment" and "boxed in" tests would have to be applied. Pet. App. 6a.

While §455(b) contemplates recusal if the judge has actual personal bias or prejudice, §455(a) requires recusal if the circumstances are such that the judge's "impartiality might be reasonably questioned" by other persons. *See Liljeberg, supra*, 108 S.Ct. at 2202. The Tenth Circuit simply ignored this distinction by

analyzing whether the bankruptcy judge appeared to have prejudged the Adversary Proceedings or to have placed himself in a position of being forced to decide one or more of the Adversary Proceedings in Kaiser's favor. Both of these questions go directly to evidence of predisposition or actual bias. No claim of actual bias was made by Petitioners, and no such test for §455(a) claims is contemplated by *Liljeberg*.

The principles of *Liljeberg*, *Barrow* and *King Resources* have assumed new importance in the administration of justice in the federal bankruptcy system as more plans of reorganization for highly leveraged companies are largely plans for litigating claims of the debtor. Congress' attempt to elevate bankruptcy judges to status comparable to the Article III judiciary requires that the bankruptcy court's function in presiding over a corporate reorganization be separated from adversary litigation upon which the success of the reorganization depends. Review by this Court is necessary to assure proper application of the *Liljeberg* "reasonable person" test in bankruptcy proceedings.

**B. The Tenth Circuit Improperly Considered Facts which Arose after Denial of the Recusal Motion.**

The Tenth Circuit considered the facts of this case as they appeared at the time of the appeal from denial of the recusal motion, rather than as they appeared at the time the recusal motion was made. Pet. App. 8a. Specifically, the court below concluded that, because settlements arising out of the Adversary Proceedings reached after the recusal motion was denied provided sufficient funds for Kaiser to pay its accrued administrative and litigation costs, the reorganization

did not depend on further recoveries from the Adversary Proceedings.

Under *Liljeberg*, the settlements reached after the recusal motion was made were improperly considered by the court below. The settlements and the fact that the first $15 million in settlement proceeds went to pay accrued administrative and litigation expenses were announced in Kaiser's Annual Report on Form 10-K filed with the Securities and Exchange Commission after the Tenth Circuit issued a stay of the trial of the Adversary Proceedings. The 10-K report, which Petitioners submitted to the court of appeals, is a further admission that Kaiser's Plan of Reorganization depended upon successful prosecution of the Adversary Proceedings. Pet. App. 41a.

Even if consideration of the settlements had been proper, the impact of such settlements was erroneously analyzed by the Tenth Circuit. The court's assertion that the settlements from the Adversary Proceedings provided funds necessary for Kaiser to cover unpaid reorganization and litigation expenses simply confirms that, but for recoveries arising out of the Adversary Proceedings, the reorganization would have failed. See Pet. App. 8a,35a-41a.

## II. THE TENTH CIRCUIT'S OPINION CONFLICTS WITH OTHER CIRCUITS.

The test for recusal applied by the Tenth Circuit does not appear in the opinion of any other circuit which has considered the issue under 28 U.S.C. §455(a). *See, e.g., In re United States*, 666 F.2d 690 (1st Cir. 1981); *Moody v. Simmons*, 858 F.2d 137 (3rd Cir. 1988), *cert. denied*, ___ U.S. ___, 109 S.Ct. 1529

(1989); *Potashnick v. Port City Construction Co., supra; Easley v. University of Michigan Board of Regents*, 853 F.2d 1351 (6th Cir. 1988); *U. S. v. Murphy*, 768 F.2d 1518 (7th Cir. 1985), *cert. denied*, 475 U.S. 1012 (1986); *In Re Manoa Finance Co., supra; King Resources, supra; U. S. v. Torkington*, 874 F.2d 1441 (11th Cir. 1989). All of the foregoing cases follow the reasonable person test.

While ignoring *Liljeberg* and purporting to apply *Barrow* and *King Resources*, the Tenth Circuit created yet another test under §455(a), thereby leaving litigants in the circuit with confusing and conflicting standards for recusal. Although Bankruptcy Judge Matheson concluded that *Barrow* and *King Resources* were no longer good law, the Tenth Circuit specifically held that those decisions "survived the recodification of bankruptcy law and are the law of this Circuit." Pet. App. 5a. However, the court of appeals failed to remand the issue to the bankruptcy court for application of the correct rule of law. In deciding the issue on its own, the court below denied petitioners the opportunity for a proper assessment of the appearance of partiality by the bankruptcy judge[2] and erroneously interpreted its own precedents without regard for the *Liljeberg* standard.

Finally, by relying on the facts which arose after denial of the recusal motion, the Tenth Circuit placed itself in conflict with thae line of decisions in other circuits which uniformly recognize that the proper time frame for consideration of relevant facts is when

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[2] Cf. *Moody v. Simmons, supra*, 858 F.2d at 142. ("Appellate courts will be most deferential to the finding of a trial judge that there is an appearance of impropriety in his continuing to sit on a case.")

the trial court is presented with a motion for recusal. *See, e.g., In re United States, supra; In re Drexel Burnham Lambert, Inc.*, 861 F.2d 1307 (2d Cir. 1988), *cert. denied*, ___ U.S. ___, 109 S.Ct. 2458 (1989); *Moody v. Simmons, supra; In re Virginia Electric and Power Co.*, 539 F.2d 357 (4th Cir. 1976); *Potashnick v. Port City Construction Co., supra; Easley v. University of Michigan Board of Regents, supra; New York City Housing Development Corp. v. Hart*, 796 F.2d 976 (7th Cir. 1986); *U.S. v. Murphy, supra; U.S. v. Balistrieri*, 779 F.2d 1191 (7th Cir. 1985), *cert. denied*, 477 U.S. 908 (1986); *In re Manoa Finance Co., supra; U.S. v. Hines*, 696 F.2d 722 (10th Cir. 1982); *Hinman v. Rogers*, 831 F.2d 937 (10th Cir. 1987); *U. S. v. Torkington, supra.*

## III. THE ISSUES PRESENTED IN THIS CASE ARE IMPORTANT TO THE ADMINISTRATION OF JUSTICE.

Kaiser's Chapter 11 case and related adversary proceedings are just one example of many LBO's that have ended in bankruptcy court and major litigation. *See, e.g., Wieboldt Stores, Inc. v. Schottenstein*, 94 B.R. 488 (N.D. Ill. 1988) (suit against shareholders who participated in LBO on claims of fraudulent conveyance); *In re The Ohio Corrugating Co.*, 91 B.R. 430 (Bankr. N.D. Ohio 1988) (suit filed by official creditors committee to avoid transfers and obligations incurred by debtor in connection with an LBO as fraudulent conveyances). Because LBO's often involve huge sums of money and have been widely utilized in many industries, the potential for the issues presented here to arise in other cases is highly probable.

The Kaiser bankruptcy and Adversary Proceedings alone have produced over 5,000 pleadings and expenditures in excess of $25 million for attorneys fees

and settlements. The size and high visibility of these proceedings dramatically focus the public interest in the appearance of impartiality on bankruptcy judges. By entertaining the issues presented herein, this Court can provide a rule to guide the parties to this case as well as litigants in similar proceedings certain to arise.

## CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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January 1990.

# APPENDIX

## APPENDIX A

## UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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JOSEPH A. FRATES, et al,

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v.

HONORABLE ZITA L. WEINSHIENK, United States District Judge and HONORABLE CHARLES E. MATHESON, United States Bankruptcy Judge,

*Respondents.*

FILED
United States Court of Appeals
Tenth Circuit
OCT 5 1989
ROBERT L. HOECKER
Clerk

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**ORDER**

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Before HOLLOWAY, Chief Judge, McKAY, LOGAN, SEYMOUR, MOORE, ANDERSON, TACHA, BALDOCK, BRORBY, and EBEL, Circuit Judges.

This matter comes on for consideration of petitioner's petition for rehearing, with suggestion for rehearing en banc, filed in the captioned matter.

Upon consideration whereof, the petition for rehearing is denied by the panel that rendered the decision.

In accordance with Rule 35(b), Federal Rules of Appellate Procedure, the petition for rehearing and suggestion

for rehearing en banc were transmitted to all of the judges who are in regular active service. No member of the panel and no judge in regular active service on the court having requested that the court be polled on rehearing en banc, Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing en banc is denied.

Entered for the Court

/s/ Robert L. Hoecker
ROBERT L. HOECKER, Clerk

## APPENDIX B

## PUBLISH

## UNITED STATES COURT OF APPEALS
## TENTH CIRCUIT

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**No. 89-1046**

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JOSEPH A. FRATES; CHARLES S. HOLMES; ROBERT E. MERRICK; STAN P. DOYLE; P. PETER PRUDDEN, III; J. ANTHONY FRATES; STEPHEN I. FRATES; EQUIVEST ASSOCIATES; DOYLE & HOLMES; EQUIVEST MANAGEMENT AND FINANCIAL SERVICES, LTD.; JOHN L. FARRELL, JR.; ASSET MANAGEMENT, INC.; CHARLES S. MCNEIL; MONTY H. RIAL; PERMA RESOURCES CORPORATION; PERMA MINING CORPORATION; PERMA PACIFIC, INC.; PERMA PACIFIC PROPERTIES; CALDER & COMPANY; CHIMNEY ROCK COAL COMPANY; ENERGY CAPITAL, LTD.; AZTEC, LTD.; COLORADO COAL RESOURCES COMPANY; and COLORADO COAL MINING;

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v.

HONORABLE ZITA L. WEINSHIENK, United States District Judge; and HONORABLE CHARLES E. MATHESON, United States Bankruptcy Judge,

*Respondents.*

FILED
United States Court of Appeals
Tenth Circuit

AUG 16 1989

ROBERT L. HOECKER
Clerk

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**Petition for a Writ of Mandamus**

---

Paul F. Hultin of Parcel, Mauro, Hultin & Spaanstra, Denver, Colorado, and Alan Bugg, Colorado Springs, Colorado (Marcus L. Squarrell and Cheryl Burnside, of Parcel, Mauro, Hultin & Spaanstra, Denver, Colorado; Thomas E. English of English, Jones & Faulkner, Tulsa, Oklahoma; Richard P. Slivka and David Dain of Vinton, Slivka & Panasci, Denver, Colorado; and Julia T. Waggener, Denver, Colorado, with them on the briefs) for petitioners.

James P. McCarthy (Melvin I. Orenstein and Daryle L. Uphoff also of Lindquist & Vennum, Minneapolis, Minnesota; H. Thomas Coghill and David J. Richman of Coghill and Goodspeed, Denver, Colorado with him on the brief) for Kaiser Steel Corporation and Kaiser Coal Corporation.

Before LOGAN, SEYMOUR, and BRORBY, Circuit Judges.

LOGAN, Circuit Judge.

This is an original proceeding in the nature of mandamus. Petitioners seek an order of this court compelling the respondent bankruptcy judge, who approved a Chapter 11 reorganization plan for Kaiser Steel Corporation (Kaiser), to disqualify himself from presiding over two adversary proceedings (the *Frates* and *Rial* proceedings) commenced by Kaiser in which Perma Pacific Properties (Perma) was a named defendant, and from serving as presiding judge in the Perma reorganization. In addition, petitioners ask us to direct the respondent district judge to vacate her refusal to order the bankruptcy judge to recuse. The *Frates* and *Rial* proceedings, in which Kaiser seeks rescission, avoidance of liens, and millions of dollars in damages, involve transactions and transfers of property

that antedate commencement of the Kaiser reorganization proceedings.

I

Petitioners seek recusal of the bankruptcy judge principally under 28 U.S.C. § 455(a), on the basis that the judge's continued participation in the proceedings presents the appearance of partiality. They rely upon two Tenth Circuit cases, *United Family Insurance Co. v. Barrow*, 452 F.2d 997 (10th Cir. 1971), and *American Employers' Insurance Co. v. King Resources Co.*, 545 F.2d 1265 (10th Cir. 1976). The bankruptcy judge, in denying the motions for recusal, expressed the view that those two decisions would have been decided differently had they arisen under the current bankruptcy code.

Some of the practices that concerned us in those cases have been eliminated, and we might have used slightly different language had the current bankruptcy code been in effect when we decided those cases. But the principles in *Barrow* and *King Resources*, properly understood, survived the recodification of bankruptcy law and are the law of this Circuit.

A bankruptcy judge may preside over both the administrative and adversarial portions of a bankruptcy case. *See* 28 U.S.C. § 157. But recusal is necessary if there is evidence of actual bias, if the bankruptcy judge by words or actions reasonably appears to have prejudged adversarial proceedings over which he is to preside, or if the judge appears "boxed in" by prior rulings such that he will be forced to reach a certain result in an adversarial proceeding regardless of the merits. We do not, however, read our cases or any other authorities to require a judge who approves a Chapter 11 reorganization plan automatically to disqualify himself from presiding over adversarial proceedings that will affect the total recovery of the bankrupt's creditors. *See Klenske v. Goo* (*In re Manoa Finance*

*Co.*), 781 F.2d 1370, 1373 (9th Cir. 1986), *cert. denied*, 479 U.S. 1064 (1987).

Here, there is no claim of actual bias. Therefore, we must determine whether the judge appears to have prejudged adversarial proceedings or to have placed himself in a position where it appears he will be forced to decide one or more of the adversary proceedings in Kaiser's favor.

II

To show the appearance of partiality, petitioners rely in part upon the judge's approval of Kaiser's Chapter 11 plan, which required him to find that "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor." 11 U.S.C. § 1129(a)(11). They also rely upon the judge's statements that without successful prosecution of the litigation there likely would be no significant cash payout for unsecured creditors. *See* Trans. Sept. 23, 1988 Hearing at 14, contained in Kaiser's Mem. in Opposition to Defendant's Motions to Stay, Ex. B (Sept. 23 hearing).

Kaiser's Chapter 11 plan has both long- and short-term aspects. The long-term focuses on four principal Kaiser assets: the Eagle Mountain mine property and railroad, contemplated to be used as a landfill for southern California cities; the stock in Fontana Water Union Company, which owns valuable water rights, proposed to be sold or leased; the Fontana waste treatment property, thought to be operable as a hazardous waste disposal facility; and the Fontana steel mill site, contemplated to be sold as valuable development real estate after environmental cleanup. The short-term aspects encompass the immediate sale of certain other assets and the pursuit of the litigation.

The court clearly believed that the long-term program was viable and not dependent upon the success of the litigation. The litigation was regarded as a possible source

of funds that could be used for immediate payout to unsecured creditors. The bankruptcy judge explicitly found that "without the prosecution of the litigation, the opportunity for a significant payout might not arise, but the underlying business programs through MRC [the waste disposal project] and Lusk [the mill site cleanup project] and the water stock and the aqueous treatment programs remain and could be operated." *Id.* Apparently the unsecured creditors own all of the stock of the reorganized Kaiser Corporation, *see* Brief of Kaiser Steel Corporation at 35; and the Retiree Medical Benefits Trust and the Pension Benefit Guaranty Corporation (PBGC) hold a majority of those shares. Thus, there will be recovery for the unsecured creditors through their equity ownership if long-term projects succeed. Thus, we hold that neither the approval of Kaiser's Chapter 11 plan nor the judge's comments on cash pay out for unsecured creditors gives the appearance of prejudgment of the litigation or so corners the judge that he seems to be required to decide the litigation in a particular manner.

III

Petitioners also cite the court's approval of a $4 million loan from PBGC to Kaiser to fund litigation, including Kaiser's pursuit of the *Frates* and *Rial* cases, as an indication of the judge's apparent partiality, or as support for the proposition that he will be forced to decide some litigation in favor of Kaiser to enable it to repay that loan. We see nothing ominous in the approval of the loan from PBGC to fund the litigation. PBGC is a twenty-eight percent shareholder in the reorganized company. It is both a secured and unsecured creditor. It is not unusual for a creditor to loan a bankruptcy estate money to pursue litigation claims; indeed, in particular circumstances we recently held it to be an abuse of discretion for a district court not to allow a creditor to fund litigation to recover assets for a bankruptcy estate. *See Bank of Woodward v.*

*Fox* (*In re Reiss*), No. 88-1992, slip op. at 6-7 (10th Cir. July 28, 1989). The bankruptcy judge in the instant case stated explicitly, "I don't think anyone has testified that without the PBGC funds the debtor would be without means to prosecute the litigation. It might be more costly, there may be more contingent fee arrangements, but I have not heard, that I can recall, that without those funds, the plan will fail." Sept. 23 Hearing at 13-14. Thus, we cannot regard approval of a loan to pursue litigation to be a prejudgment that the litigation will succeed.

Further, because we consider the facts as they appear at the time we are considering the mandamus request, we note that settlements already have been approved with persons other than petitioners bringing in more than $21 million, a sum apparently sufficient to cover all administrative and litigation costs, and to permit distributions to unsecured creditors. *See* Kaiser Steel Resources, Inc., 1988 Annual Report on SEC Form 10-K at 67 (1989), *contained* in Addendum to Reply Brief of Petitioners at 67. Thus, it seems quite apparent that the judge need not decide against the *Frates* and *Rial* petitioners to ensure that the reorganized company has the funds to pay administrative and litigation costs.

## IV

More bothersome is petitioner's argument that the bankruptcy judge already has decided specific issues in the Kaiser bankruptcy proceedings that indicate prejudgment or would essentially force the judge to make rulings in the *Frates* and *Rial* proceedings in favor of Kaiser. Petitioners cite several such instances: approving rejection of leases and executory contracts, consenting to settlement agreements, and finding alleged assets to be of small or no value. *See* Supplemental Brief of Petitioners at 14-24. Petitioners say that Kaiser's financial condition, including the value of its assets at the time of the transactions challenged in *Frates* and *Rial*, is crucial to their defense.

Kaiser makes various responses. First, it points out that all of these cited rulings were made more than a year before petitioners sought the recusal. We do not regard the delay as fatal to petitioners' cause, because a recusal motion should be permitted at any time it becomes apparent that a judge is biased or suffers from the appearance of bias. But the delay does indicate that petitioners did not regard these rulings as greatly debilitating to their cases. We also must recognize that "familiarity with defendants and/or the facts of a case that arises from earlier participation in judicial proceedings is not sufficient to disqualify a judge from presiding at a later trial." *In re Corrugated Container Antitrust Litigation*, 614 F.2d 958, 965 (5th Cir.) (footnote omitted), *cert. denied* 449 U.S. 888 (1980). In many ordinary litigation situations judges make preliminary decisions on offers of evidence, or make decisions otherwise affecting the parties, that familiarize the judge with the facts in that case or in related cases in which the judge must rule. Kaiser correctly points out that 28 U.S.C. § 157, by permitting the presiding judge in a reorganization to preside over adversary proceedings affecting the assets, contemplates that bankruptcy judges will encounter situations similar to that before us with some frequency.

Further, Kaiser asserts that many of the rulings were in uncontested proceedings and, therefore, the judge acted without hearings or rejected objections on different grounds than would be in issue in *Frates* or *Rail* (e.g., the judge rejected executory mining consulting contracts with Perma because Kaiser was not in need of the services under the agreements). Kaiser also challenges petitioners' assumption that these rulings are connected to the *Frates* and *Rail* proceedings. Although we are handicapped by not having all of the bankruptcy court and district court records, we have carefully reviewed the briefs and exhibits provided us, and we see nothing which convinces us that the bankruptcy judge appears to have prejudged issues involved in

the *Frates* and *Rial* litigation or has placed himself in such a position that he will be forced to decide an issue in favor of Kaiser regardless of the evidence presented to him in that litigation.

V

With respect to Perma's separate motion for recusal, at first blush it would appear that the bankruptcy judge should not oversee the Chapter 11 reorganizations of two parties that are opposing each other in litigation before him. The bankruptcy judge, however, has approved a Chapter 11 plan only for Kaiser, and has found that the success of that plan is not dependent upon the success of Kaiser's lawsuit against Perma. Perma, on the other hand, apparently had not reason to file bankruptcy except for the suit filed against it by Kaiser, which seeks return to Kaiser of Perma's major asset. By filing, Perma used the bankruptcy to obtain an automatic stay of Kaiser's litigation against it. The bankruptcy court apparently has not yet approved a Chapter 11 plan for Perma.

Perma in effect has forced Kaiser to pursue its suit as an ordinary claim under 11 U.S.C. § 502 in the Perma bankruptcy case. While Perma has sold some assets, with court approval, the proceeds were placed in an escrow account, apparently at Perma's request, pending the outcome of Kaiser's claim. Perma apparently has not sought approval of any loan for litigation expenses or approval of expenditures to defend against Kaiser's claim. Thus, we do not see that the bankruptcy judge has as yet acted in any way that might be considered prejudging the litigation or prejudicing Perma. In refusing Perma's motion for his recusal, the judge stated that the time might come when he would have to recuse. That time may come soon. But considering the current status of the Kaiser-Perma litigation and the Perma bankruptcy, that moment is not yet upon us.

## VI

In conclusion, we hold that petitioners have not established actual bias by the bankruptcy judge or an appearance of such partiality as to require recusal in the *Frates* and *Rial* litigation nor, as yet, has it been shown in the Perma Chapter 11 proceeding. We also have been shown no rulings convincing us that the judge has placed himself in a position in which he must decide an adversarial proceeding in favor of any one party to vindicate some prior action he has taken.

The petition for a writ of mandamus is DENIED.

## APPENDIX C

## IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLORADO

---

**Civil Action No. 89-Z-86**

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JOSEPH A. FRATES, CHARLES S. HOLMES, ROBERT E. MERRICK, STAN P. DOYLE, P. PETER PRUDDEN, III, J. ANTHONY FRATES, STEPHEN I. FRATES, EQUIVEST ASSOCIATES, DOYLE & HOLMES, EQUIVEST MANAGEMENT AND FINANCIAL SERVICES, LTD., JOHN L. FARRELL, JR., ASSET MANAGEMENT, INC., CHARLES S. McNEIL, MONTY H. RIAL, DONALDSON, LUFKIN & JENRETTE SECURITIES CORPORATION, CHARLES H. BLACK, CLIFFORD V. BROKAW, III, PERMA RESOURCES CORPORATION, PERMA MINING CORPORATION, PERMA PACIFIC, INC., PERMA PACIFIC PROPERTIES, CALDER & COMPANY, CHIMNEY ROCK COAL COMPANY, ENERGY CAPITAL, LTD., AZTEC, LTD., COLORADO COAL RESOURCES COMPANY, and COLORADO COAL MINING,

*Petitioners,*

v.

CHIEF BANKRUPTCY JUDGE CHARLES E. MATHESON,

*Respondent.*

FILED
UNITED STATES DISTRICT COURT
DENVER, COLORADO

FEB 13 1989

JAMES R. MANSPEAKER
CLERK
BY _____
DEP. CLERK

## ORDER

The matters before the Court are a Petition For Writ of Mandamus and petitioner's Motion For Stay Pending Decision On Petition For Writ Of Mandamus.

Because the Court can find no error in the decision below, it is

ORDERED that the Petition For Writ Of Mandamus is denied. It is

FURTHER ORDERED that petitioner's Motion For Stay Pending Decision On Petition For Writ Of Mandamus is denied. It is

FURTHER ORDERED that the cause of action is dismissed.

DATED at Denver, Colorado, this 13th day of February, 1989.

BY THE COURT:

/s/ Zita L. Weinshienk
ZITA L. WEINSHIENK,
Judge
United States District Court

## APPENDIX D

## IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF COLORADO

---

**Case No. 87-B-1553E**
**Chapter 11 Case**
**(Jointly Administered)**

---

In re:
KAISER STEEL CORPORATION,

*Debtor.*

---

**Adversary Proceeding**
**No. 87 E 135**

---

KAISER STEEL CORPORATION, et al.,

*Plaintiffs,*

vs.

JOSEPH A. FRATES, et al.,

*Defendants.*

---

**Adversary Proceeding**
**No. 87 E 437**

---

KAISER STEEL CORPORATION, et al.,

*Plaintiffs,*

vs.

MONTY H. RIAL, et al.,

*Defendants.*

**TRANSCRIPT OF HEARING**
December 16, 1988

APPEARANCES:

PARCEL, MAURO, HULTIN & SPAANSTRA
By Paul F. Hultin, Esq.
and
Jamie Harrison, Esq.
and
Cheryl Burnside, Esq.
1801 California Street, Suite 3600
Denver, Colorado 80202
Appearing on behalf of Defendants
Joseph A. Frates, Charles S. Holmes,
Robert E. Merrick, Equivest Associates,
a partnership, Stan P. Doyle,
J. Anthony Frates, P. Peter Prudden, III,
Stephen I. Frates, John L. Farrell,
Equivest Management and Financial
Services, Ltd., and Asset Management, Inc.

* * *

THE COURT: I take some slight exception to the characterization of what the motion is and to the suggestion by Mr. Hultin that the motions are framed other than on the proposition that as to the reorganization case, as the judge who has confirmed the plan in that case, as a matter of law, I have to be disqualified. The Motion for Recusal states, "This request is based on the well established rule in this circuit that the judicial officer who presides over reorganization proceedings should not also hear actions that may have a significant impact on the reorganization." That was the proposition.

Not that I've heard matters that would give rise to prejudice or taken other actions in that case, but on the proposition that the law in this circuit mandates that I should recuse myself in these adversaries because I'm the

case judge in the reorganization case. That was the motion, Mr. Hultin.

The argument was that the judicial officer who presides over a debtor's reorganization proceeding should also not hear actions on which the success of failure of the reorganization might depend. That was the argument. That was the proposition and that's the only proposition of this matter and that's the proposition that's before me.

On that proposition, there is a significant question of whether the Motions for Recusal are timely because that proposition has been known from day one. Under 455(a), as counsel has pointed out, the Court is obligated to recuse itself if the impartiality of the Court can reasonably be questioned. There is a flip side to that in that the Court is also admonished that it ought not to recuse itself merely upon every assertion that may be brought in, but that some party claims that they have some feeling that the judge may not be impartial. There is an obligation of this Court to hear its cases and not foster them off onto other judges in the bankruptcy court who are equally as busy.

The suggestion brought forward, I think, is one that would be somewhat startling to almost any bankruptcy judge across the country. And if liberally and literally applied, would almost effectively mandate that the case judge hear nothing else except the hearing on the plan for reorganization, because virtually anything else that the judge hears is going to have an impact on the case and on the creditors.

Congress recognized the problem very clearly. Under the Bankruptcy Act, as cases were administered, the bankruptcy referee or judge, as they finally became known, were very heavily involved in the administration of the case. They heard every creditors' meeting at which a wide variety of matters were discussed freely concerning the debtors' affairs and the representations made, et cetera. The case judge signed all the checks for the debtor, set

the officers' salaries. The case judge ruled on whether—in the Chapter 11s and Chapter 10s even, to the given dollar amount, whether the debtor in possession ought to remain in operation and, if so, the scope of those operations.

The case judge appointed the trustee, as Judge Winter did in the King Resources case, when he appointed Charles Baird. That kind of involvement was talked about very explicitly in the legislative history in the enactment of the Bankruptcy Code in the House Report 95-595. The House Report talks about the cronyism, charges of cronyism, problems with the close relationships between the bankruptcy judges and those who were regularly appearing in front of them representing trustees and debtors, and makes note of what Congress was seeking to do in the enactment of the Bankruptcy Code and the changing of the judicial system in which matters were to be heard.

The House Report states at Page 107, "These changes in the present bankruptcy administrative system will accomplish the separation of judicial and administrative functions currently performed by the bankruptcy judges. The judges will become passive arbiters in disputes that arise in bankruptcy cases. United States Trustees will assume the bankruptcy judges' current supervisory roles over the conduct of bankruptcy cases and over individuals servicing in the bankruptcy system. More responsibility for administration of cases will be shifted to the trustees that serve in cases, whether they are private members of the panel or the United States trustee. Another change proposed by the bill facilitates the shift of responsibility and the placement of the bankruptcy judge in the dispute deciding role."

And at Page 108, "This concept embodied in the phrase after notice and hearing will free the judge from ruling on the many undisputed administrative decisions that must be made in a case and will involve the judge only when there's an actual dispute to be resolved. It should eliminate

the need for continual requests for instructions by the trustee and should significantly reduce, if not eliminate, the amount of exparte contacts currently required between the bankruptcy judge and the trustee. In sum, the bankruptcy judge will be separated from the administration of the case and his duties will be solely judicial."

On Page 228, in discussing the requirements of 1125 of the Code, "First and most important, the Court will be required to approve a disclosure statement before there may be any solicitation of acceptances or rejections of a plan. With the bankruptcy judges under this bill less involved in the administration of the reorganization cases than they are under current law, they will be fair arbiters in compliance with the statutory standards. They will no longer have the same interests they have today in seeing that each reorganization is successful. An interest which has led to a suspicion of bias on the part of many dealing with the Bankruptcy Court."

The cases that have been cited arose under the Bankruptcy Act, an act that was flawed and that Congress recognized the flaws. Flaws that led to the appearance of impartiality or lack of impartiality on behalf of the case judge, and took steps to correct that. I would be bound, without question, by the Tenth Circuit decisions if this were an Act case by the law that is espoused in those decisions. I would be bound now unless there was a reasonable basis to believe that the Tenth Circuit, in light of the policies explicitly voiced by Congress in the enactment of the Bankruptcy Code and the changes that have been made in that Code, would not follow the precedent established in those decisions. And I sincerely believe that was the intent and the purpose of the law in the code, and for that reason, as to the adversary matters, I will not recuse myself.

As to the Perma Pacific reorganization case, there may come a time, Mr. Bugg, when because of the interrela-

tionship of those two proceedings and matters that are going on in those two cases, that it would be proper for me to consider recusal. I do not believe there are any such matters pending now other than the existence of this adversary proceeding and, therefore, I don't think that it is necessary for me to act on that at the present time.

There is no authority that has been cited that would indicate that I must, as the presiding judge in one proceeding, recuse myself from acting as the presiding judge in another proceeding because the two proceedings are interrelated. A fairly common occurrence before this Court.

And since there is no affidavit or charge of actual impartiality or partiality or bias, I will not enter an order for recusal in the underlying reorganization case for Perma.

* * *

MR. HULTIN: Your Honor, if I may interject myself just briefly. For the record, I would note our motion that you stayed in consideration of any further motions, and I would like to ask one point of clarification, Your Honor, on the basis of your ruling.

Is Your Honor making an explicit finding that a reasonable person would be knowledgeable about the legislative history that Your Honor has cited here and would ignore the facial conflict between the adversary proceedings, the Kaiser reorganization and the Perma reorganization?

I think that's very pertinent to any appellate review of your ruling, Your Honor, based on the Liljeberg case and many other Court of Appeals cases construing 455.

THE COURT: Once again, Mr. Hultin, I addressed the motion that you filed, which was that the law in this circuit established that the reorganization case judge could not be viewed as being impartial to hear other matters or proceedings that could have a bearing on the reorganization.

MR. HULTIN: Your Honor, I think the motion speaks for itself.

THE COURT: I think it does, too.

MR. HULTIN: And the argument here speaks for itself and I would ask Your Honor to clarify that point.

THE COURT: I believe I've ruled on your motion, Mr. Hultin.

MR. HULTIN: Are you refusing to make that finding, Your Honor?

THE COURT: I believe I made my grounds and my findings in response to the motion that, by reason of taking the reorganization judge out of the administrative affairs of the estate, it was the intention of Congress to create a judicial body and that there has been no authority cited that would establish that a judge, under those circumstances, is automatically subject to recusal for the appearance of partiality.

MR. HULTIN: I understand that, Your Honor. You also found that but for the '84 amendments, you would be bound by Tenth Circuit authority to recuse yourself; is that correct?

THE COURT: No, I found that if this were an Act case, the Tenth Circuit decisions would be binding on me and I would have to follow those decisions if I thought—and I would have to follow them now if I thought that the law had remained the same. But that the law has not remained the same and, therefore, I do not feel the Tenth Circuit confronted with the same facts and circumstances, would rule similarly.

MR. HULTIN: But for that change in the law, though, Your Honor would rule that Your Honor would have to recuse himself; is that correct?

THE COURT: Mr. Hultin, do not put words in my mouth.

MR. HULTIN: I think it's unclear, Your Honor.

THE COURT: I will state my findings and my rulings and do not state them for me.

MR. HULTIN: I'm not purporting to, Your Honor. I'm attempting to understand Your Honor's rulings and Your Honor's comments in that regard and I think any appellate court would like to understand that as well because it is our intent to appeal, Your Honor.

THE COURT: I think that's fine. I think any appellate court will understand my rulings.

MR. HULTIN: Your Honor, we would ask for a ruling on our motion to stay any further actions in this case so we could immediately seek, by way of writ of mandamus, an immediate appeal of review of your decision here today.

THE COURT: That motion will be denied, Mr. Hultin. I feel rather strongly on the point of law that is involved and on what Congress intended to create—has created, and because of that, I think it would be intolerable to let these proceedings sit in limbo for some extended period of time while the appellate process works, so we'll go forward.

MR. HULTIN: Thank you, Your Honor.

* * *

## APPENDIX E

## IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF COLORADO

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**Case No. 87 B 1552 E**
**(Jointly Administered Chapter 11 Case)**

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In re: KAISER STEEL CORPORATION,

*Debtor.*

---

**Adversary Proceeding**
**No. 87 E 135**

---

KAISER STEEL CORPORATION, *et al.*,

*Plaintiffs*

v.

JOSEPH A. FRATES, *et al.*,

*Defendants*

---

**Adversary Proceeding**
**No. 87 E 437**

---

KAISER STEEL CORPORATION, *et al.*,

*Plaintiffs.*

v.

MONTY H. RIAL, *et al.*,

*Defendants.*

FILED
UNITED STATES BANKRUPTCY COURT
DISTRICT OF COLORADO

DEC 16 1988

BY BRADFORD L. BOLTON, Clerk
DEPUTY CLERK

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**SUPPLEMENTAL MEMORANDUM IN SUPPORT OF MOTION FOR RECUSAL**

---

Defendants Joseph A. Frates, Robert E. Merrick, Charles S. Holmes, and Stan P. Doyle (the "Frates Defendants"), respectfully submit this Supplemental Memorandum in Support of the Motion for Recusal filed by Defendants Joseph A. Frates, Charles S. Holmes, Robert E. Merrick, Stan P. Doyle, P. Peter Prudden, III, J. Anthony Frates, Stephen I. Frates, Equivest Associates, Doyle & Holmes, Equivest Management and Financial Services, Ltd., John L. Farrell, Asset Management, Inc., William R. Gould, Howard P. Allen, Charles S. McNeil, Monty H. Rial, Donaldson, Lufkin & Jenrette, Dr. Eustace H. Winn, Jr., Charles H. Black, Richard N. Gary, Stephen A. Girard, Lloyd G. Hansen, Clifford V. Brokaw, III, and Miles B. Yeagley on November 4, 1988 to provide newly discovered evidence in support of the Motion for Recusal. Defendants state:

1. Bruce E. Hendry, a current member of the Board of Directors of Kaiser and Chairman and Chief Executive Officer of Kaiser during the course of its Chapter XI proceedings, was deposed by certain defendants on December 14, 1988.

2. In his deposition, Mr. Hendry made clear the fact that Kaiser's success in these adversary proceedings is critical to the success of Kaiser's Plan of Reorganization and that proceeds from these adversary proceedings are the only potential source of funds available to pay $3-4 million in unpaid administrative expenses incurred in the reorganization process, and are the only source of funds

from which the unsecured creditors can hope to be paid. Mr. Hendry responded to questions as follows:

Question: [I]sn't it a fact, Mr. Hendry, that if these lawsuits are not successful, the unsecured creditors will receive—are not likely to receive any cash distributions as a result of the reorganization?

Mr. Hendry: That's correct.

Question: And isn't it also a fact that these lawsuits need to be successfully prosecuted in order for Kaiser to be able to pay its administrative expenses as a result of the reorganization?

Mr. Hendry: Yes. In order to pay those fees, we have to have a successful litigation effort, that's correct.

Question: Would it be fair to say that the economics of that development [The Kaiser Lusk Joint Venture] are significantly impacted by whether or not Kaiser can deliver the West End property?

Mr. Hendry: Yes, that would be correct.

Transcript of excerpt of Deposition of Bruce E. Hendry, December 14, 1988, pp. 4, 8. A portion of the transcript dealing with Mr. Hendry's testimony regarding the critical role of these adversary proceedings to the success of Kaiser's Plan of Reorganization is attached hereto as Exhibit A and incorporated herein by this reference.

3. Mr. Hendry also testified regarding the Kaiser/Lusk Joint Venture that: 1) the Lusk Company has the discretionary right to withdraw at anytime from its agreement with Kaiser to joint venture the development of Kaiser's Fontana property; 2) the West End is the only property in the Joint Venture which is environmentally safe; 3) the

West End is the only large property which is immediately developable; and 4) without the West End property, the ownership of which Kaiser is attempting to regain in these adversary proceedings, the prospect of revenues to the joint venture would be limited to cleaning up one section of the site, selling it, cleaning up another section, and so on. Mr. Hendry testified that absent the West End property, it is unlikely there will be any surplus cash flow from the joint venture that would be available to go to any shareholders of the reorganized Kaiser and, as noted above, that without the West End Property the project economics are significantly impacted. (Exhibit A pp. 6-8).

4. Mr. Hendry further testified that Kaiser's cash flow from sources other than the litigation will not go to anything other than to "keep the door open." (Exhibit A, p. 9). Mr. Hendry's testimony unquestionably confirms Defendants' assertion that Kaiser's successful reorganization is dependent upon Kaiser prevailing in these adversary proceedings.

5. Under the facts established by Mr. Hendry's testimony, the Tenth Circuit cases cited by Defendants in the Motion for Recusal are dispositive: where the success of a reorganization is dependent upon the success of related litigation in which the debtor is a party, a single judge may not preside over both proceedings. *See American Employers' Insurance Company v. King Resources Co.*, 545 F.2d 1265 (10th Cir. 1976) and *United Family Life Insurance Co. v. Barrow*, 452 F.2d 997 (10th Cir. 1971).

WHEREFORE, the Frates Defendants submit that based on the attached testimony of Bruce E. Hendry that the Motion for Recusal must be granted.

Respectfully submitted this 16th day of December, 1988.

PARCEL, MAURO, HULTIN & SPAANSTRA

By /s/ Paul Hultin

Paul F. Hultin
Marcus L. Squarrell
David A. Bailey
1801 California Street, #3600
Denver, CO 80202
Telephone: (303) 292-6400

ATTORNEYS FOR DEFENDANTS JOSEPH A. FRATES, CHARLES S. HOLMES, ROBERT E. MERRICK, STAN P. DOYLE

Pursuant to Notice and the Federal Rules of Civil Procedure, the deposition of BRUCE E. HENDRY, called by Defendants the Frates Group, was taken on Wednesday, December 14, 1988, commencing at 10:15 a.m., at 633 - 17th Street, Denver, Colorado, before Judi Walker, Registered Professional Reporter and Notary Public within and for the State of Colorado.

PROCEEDINGS

BRUCE E. HENDRY,

being first duly sworn in the above cause, was examined and testified as follows:

* * *

EXAMINATION

BY MR. HULTIN:

Q. Now, isn't it a fact, Mr. Hendry, that if these lawsuits are not successful, the unsecured creditors will receive—are not likely to receive any cash distributions as a result of the reorganization?

A. That's correct.

Q. And isn't it also a fact that these lawsuits need to be successfully prosecuted in order for Kaiser to be able to pay its administrative expenses as a result of the reorganization?

A. Yes. In order to pay those fees, we have to have a successful litigation effort, that's correct.

Q. What is the amount of the current outstanding administrative expenses that have not yet been paid?

A. I don't know the final figure. I can give you the ballpark range, but I don't know the specific figure.

Q. Please give me the ballpark.

A. 3 to $4 million.

Q. And those aren't going to get paid unless there's some money out of these cases, right?

A. That's correct.

Q. Now, tell me about the Lusk joint venture.

A. Well, we have a joint venture with Mr. Lusk to develop the old steel mill site and industrial development real estate—industrial development project.

Q. We've talking earlier about the West End property.

A. Yes.

Q. Who is the current owner of the West End property?

A. I believe Perma is still the current owner.

Q. Is that Perma Pacific, Inc.?

A. I believe that's correct.

Q. They're in bankruptcy, are they not?

A. Yes, they are.

Q. And isn't it a fact that Kaiser is trying to recover the West End property from Perma Pacific?

A. That is correct, yes.

Q. And isn't it a fact that that property is essential for the Lusk joint venture?

A. No, that is not.

Q. Is it important to the Lusk joint venture?

A. Is important.

Q. Describe to me the role it plays in the Lusk joint venture.

A. The West End property is the property that is essentially environmentally safe and, of course, the reason why it was transferred out of Kaiser Steel's ownership was because it didn't have the environmental problems on it

and as a result of that, the property is essentially developable right now where the remaining Kaiser properties are not developable because of the environmental damage on them.

Q. So of the properties that are subject to the joint venture with Lusk, the West End would be the only property that would be immediately developable?

A. I'm not sure it's the only property. It's certainly the only large piece of property that would be immediately developable.

Q. So there would be no cash that could come from the development process, then, absent the West End until all of the environmental remediation work has been done on all the other properties; is that a correct statement?

A. No, that is not correct. Our feeling is that we can clean up portions of the mill site and develop it using the cash flow from the sale of that property to clean up the next portion. And it's not anticipated that we will clean the entire property up before development starts.

Q. I see. But all of the cash flow, then, is going to go to the next phase remediation process; is that correct?

A. It depends how expensive that is and, of course, we don't know that right now, but that is entirely possible, right, that will happen.

Q. Absent return of the West End properties, sir, is there even a remote chance that there would be any surplus cash flow from a Lusk joint venture that would be available to go to any of the shareholders of the reorganized Kaiser?

A. It's unlikely.

Q. It would be all incurred in this ongoing environmental remediation process; is that correct?

A. That would be the most likely event, yes.

Q. So it would be very desireable for Kaiser holdings to recover the West End property?

A. Yes, it would.

Q. And, indeed, if Kaiser does not deliver the West End property by a certain time, Lusk has the option to terminate his participation in the joint venture, does he not?

A. My understanding of the agreement is that he can terminate the agreement, but it would be based on his assessment of the amount of money it would take to clean the site up rather than whether we get the West End property back.

Q. But he basically has a discretionary—

A. He does.

Q. —right to terminate; is that correct?

A. He does. He does, yes.

Q. Would it be fair to say that the economics of that development are insignificantly impacted by whether or not Kaiser can deliver the West End property?

A. Yes, that would be correct.

THE DEPONENT: May I take about a one-minute break here?

MR. HULTIN: Why don't we take five minutes.

(A recess was taken.)

Q. (BY MR. HULTIN) Mr. Hendry, it's my understanding that there's one other business venture—significant business venture that's involved in the Kaiser holdings which is the reorganized entity, and that's the Eagle Mount solid waste disposal project with MRC; is that correct?

A. Yes, that's correct

(Brief interruption.)

(The last question and answer were read.)

Q. (BY MR. HULTIN) So we've got the lawsuits, the Lusk joint venture and the Eagle Mount joint venture. There's Kaiser's business holdings as well.

A. There are other things as well, but those are the main things.

Q. When does Kaiser project to receive cash flow from the Eagle Mountain/MRC joint venture?

A. I believe the agreement calls for payments starting in '91 or '92.

Q. That assumes that the project is successful?

A. I believe the payments have to start irregardless, but it would be a credit against future revenues, but, ultimately, of course, the project has to be successful.

Q. Now, that project involves significant environmental approvals, does it not?

A. Yes, it does.

Q. Have those been obtained as of this date?

A. No.

Q. Does Kaiser holdings have any expectation of any cash flow other than from these lawsuits over the next two or three yeas?

A. Over the next two or three years I doubt that it will have any cash from—any significant cash flow from our businesses.

Q. Other than from these lawsuits?

A. Well, we do have existing cash flow from smaller sources that will—

Q. Is that going to do anying other than keep the door open?

A. No, it will not.

Q. Will it be sufficient to keep the doors open?

A. I believe it will, yes.

Q. What are those businesses?

A. We sell slag to two buyers. There's significant scrap sale which had and will continue to be made.

Q. Scrap metal

A. Well, scrap. Mostly metal, but there are small engines and other things that were the residual of the old steel mill site that we continue to sell off as essentially scrap. There are other materials which are called revert materials which are sold to yet another purchaser.

Q. Revert?

A. It's something with a high iron ore content that is mixed with some other product. I'm not sure what it is, but it gives us a cash flow.

We have rentals both at Eagle Mountain and we were renting some 30 or 40 houses to the state of California with plans to rent additional houses to them or others. We have virtually a town up there that's vacant.

Q. Lake Tamarisk?

A. Lake Tamarisk and we have another town that we own which has additional lots, so there is a cash flow coming into the company that will keep the doors open essentially.

Q. But would it be fair to say that the retirees are the largest creditors of the Kaiser Estate, both in terms of dollars and in terms of numbers?

A. Yes.

Q. And would it be fair to say that they get nothing if Kaiser is not successful in the lawsuits?

A. That is true if you put a time period on it. Let's say the next two to three years. Beyond that, of course, we hope to have Kaiser Steel Resources, which is the new official name of the company—

Q. Kaiser Holdings, Inc. is now Kaiser Steel Resources, Inc.?

A. That's correct. Over the next two or three years, these projects I've discussed will start producing some cash flow,

but certainly over the next two or three years what the retirees can expect is from the successful conclusion of these lawsuits.

Q. And they have immediate critical need for cash, do they not?

A. They have a need for cash. They have been funded for the next two years already. So, yes, after the next two years, they will have to get some additional cash or have to cut back on benefits.

* * *

Q. Let me digress. Just before the break, Mr. Hendry, I asked you some questions about some current administrative expenses in the amount of 3 to $4 million that you said were unpaid.

What do those consist of? Are those unpaid attorney's fees?

A. Essentially, yes.

Q. And the law firms have given notes of taken notes from Kaiser for those?

A. Yes.

Q. And interest is accruing at, what 12 percent on those notes?

A. I don't recall. I think 10 or 12 is the figure that I recall.

Q. Okay. Do you know whether New York Life has been paid in full?

A. I do not.

MR. GLENNON: I have 3204, by the say.

MR. HULTIN: You do have it?

MR. GLENNON: Yes.

Q. (BY MR. HULTIN) New York Life had an administrative claim in the amount of about $3.1 million, a confirmation that they took a note rather than cash?

A. Yes.

Q. But for that note, the plan would not have been confirmable; is that correct?

A. I believe that's correct, right.

Q And you don't know whether that's been paid or not?

A. I don't believe I've—I don't know whether that's been paid.

* * *

(The deposition recessed at 5:45 p.m., December 14, 1988.)

APPENDIX F

SECURITIES AND EXCHANGE COMMISSION
**Washington, D. C. 20549**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF
THE SECURITIES EXCHANGE ACT OF 1934

**For the Period November 16, 1988**
**to December 31, 1988**

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FORM 10-K

**Commission File Number 1-7651**

**94-0594733**
**(I.R.S. Employer Identification No.)**

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KAISER STEEL RESOURCES, INC.
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of incorporation or jurisdiction)

**8300 Utica Avenue**
**Suite 301**
**Rancho Cucamonga, CA 91730**
**(Address of principal executive offices and zip code)**

PART I

Item 1. BUSINESS

"Kaiser" or "the Company" when used in this Form 10-K refers to Kaiser Resources, Inc., including, where applicable, its consolidated subsidiaries.

*Emergence from Bankruptcy*

On September 23, 1988, Kaiser Steel Resources, Inc., a Delaware corporation (the "Company"), emerged from bankruptcy proceedings as the recognized successor to Kaiser Steel Corporation pursuant to confirmation of the Second Amended Joint Plan of Reorganization, As Modified (the "Plan of Reorganization"), upon order of the United States Bankruptcy Court for the District of Colorado (the "Bankruptcy Court"). The Plan of Reorganization was implemented effective November 15, 1988.

* * *

The former creditors of Kaiser Steel Corporation (but not former or current Management, or Employees) received, in addition to shares of common stock of the Company, the right to proceeds from the sale of excess properties (less certain administrative and priority payments) not retained by the Company and the net distributable proceeds received from prosecution of the litigation initiated during the Bankruptcy. The net distributable proceeds will not be retained by the Company but will be distributed directly to the Company's former creditors. The allocations for such distributions are set forth below:

| | |
|---|---|
| 1. Retiree Medical Benefits Trust | 52.5% |
| 2. Pension Benefit Guaranty Corporation | 28.0% |
| 3. Retiree Pension Trust | 4.0% |
| 4. General Unsecured Claimants | 15.5% |
| | 100.0% |

Pursuant to the Plan of Reorganization, certain liabilities of the Company for the administrative costs of the bankruptcy, prior tax claims, mining reclamation claims, prior-

ity and administrative claims, litigation expenses, and claims administration costs can be paid from proceeds from successful litigation or asset sales prior to any distribution of proceeds to creditors.

* * *

II. *Adversary Litigation*

Through the bankruptcy reorganization process, Kaiser Steel Corporation, as debtor-in-possession, commenced lawsuits seeking to recover damages, money and property transferred from the Company over the last several years, principally relating to the 1984 Leveraged Buyout Transaction ("LBO"), the 1985 Exchange, the TIPs Program, and actions of directors and professionals in approving the 1984 LBO and subsequent transactions. These lawsuits are collectively referred to as the "Adversary Litigation." The net cash proceeds recovered in these suits will become "Distributable Proceeds" payable to creditors in accordance with the Plan of Reorganization. The principal actions now pending are described below. Recoveries in the Adversary Litigation are expected to be the principal source of cash distributions to unsecured creditors and an alternative source of payment of certain priority and administrative expenses. If the Adversary Litigation cases are minimally or not successful, there may be only nominal or no cash distributions to unsecured creditors and the Company will be obligated for the liquidation costs and the unpaid priority and administrative expenses.

The costs and expenses associated with pursuing the Adversary Litigation are significant. To fund these expenses, the PBGC and the Company entered into a loan agreement providing for the PBGC to extend a $4 million line of credit. The loan proceeds are to be used solely to fund the litigation costs. The line of credit is a 30-month loan, at a fixed 10% interest rate, secured by the following assets of the Company:

1. The West Slag Pile and underlying real estate (located on a portion of the former steel mill site);

2. The Chino Basin water rights appurtenant to the Fontana steel will site property; and

3. Certain property at Lake Tamarisk, a small development located near the Company's Eagle Mountain mine complex.

Funding of the costs and expenses of the Adversary Litigation will also be defrayed with proceeds from the settlement agreements described below.

* * *

B. *1985 Exchange Litigation (the "1985 Exchange Case").* In February, 1987, the Company filed a lawsuit in the Bankruptcy Court challenging three groups of transactions: The "April 1985 Exchange," the "West End Property Transactions," and the "Cottonwood Transaction." As noted below, settlement agreements have been entered into with certain of the defendants.

C. *TIPs Litigation (the "TIPs Case").* In June, 1987, Kaiser Steel Corporation and Kaiser Coal Corporation filed a Complaint in the Bankruptcy Court captioned *Kaiser Steel Corporation v. Monty H. Rial, et al.* (the "TIPs Case"). In this lawsuit, the Company seeks to set aside and recover various payments and transfers made to members or affiliates of the Frates Group and the Rial-Perma Group during the period from March, 1984, through January, 1987.

* * *

The Company has entered into settlement agreements with a number of the defendants in the 1985 Exchange Case and the TIPs Case, including Donaldson, Lufkin & Jenrette Securities Corporation ("DLJ"), Dean Witter Reynolds, Inc., Southern California Edison, Clifford Brokaw,

Dr. Eustice H. Winn and the directors and officers who were not members of the Rial-Perma or Frates Groups. The settlement agreements have been approved by the Bankruptcy Court.

Certain settlement payments have been made. The bulk of the remaining settlements will be paid to the Company upon final resolution of any appeals to the Bankruptcy Court Orders approving the settlements. Resolution of any appeals could delay receipt of the founds for an indeterminate period; however, the funds are to be held in an interest-bearing escrow account pending distribution. Pursuant to the Plan of Reorganization, the litigation proceeds, after recovery of the litigation expenses and creation of appropriate reserves for future Adversary Litigation expenses, wil be used to pay administrative and priority expenses incurred through the bankruptcy reorganization process, with the balance available for distribution to Kaiser Steel Corporation's general unsecured creditors.

* * *

Note 2 REORGANIZATION PROCEEDINGS

The amounts included as liabilities subject to Chapter 11 proceedings at December 31, 1988, consist of:

| | |
|---|---|
| Accrued professional fees, including interest of $180,555 | $5,024,186 |
| Resolved administrative claim, including interest of $136,882 | 3,236,882 |
| Disputed secured claim, including disputed interest of $148,755, discussed below | 425,939 |
| Property taxes payable | 345,337 |
| | $9,032,344 |

The Plan of Reorganization provides that the liabilities noted above may be repaid from the proceeds generated from the sale of designated assets (which is substantially

complete) and the recoveries, if any, from various lawsuits which the Company, as debtor-in-possession, had filed or would file against its former owners, directors, officers and advisors (Note 16). The proceeds generated, if any, from these two sources become "distributable proceeds." As such, the Plan calls for the distribution of these proceeds to the Company's former creditors, net of the following:

1) A reasonable reserve for the operations of the reorganized company;
2) All actual and anticipated costs of litigation; and
3) All costs associated with the bankruptcy claims resolution process.

* * *

II. *Adversary Litigation*

Through the bankruptcy reorganization process, Kaiser commenced lawsuits seeking to recover damages for money and property transferred from the Company over the last several years, principally relating to the 1984 Leveraged Buyout, certain property exchanges, certain payments to officers and directors, and actions of directors and professionals in approving the subsequent transactions. These lawsuits are collectively referred to as the "Adversary Litigation." Any net cash proceeds recovered in these suits will become "Distributable Proceeds" payable to creditors in accordance with the Plan of Reorganization (Notes 2 and 16).

* * *

Note 16 SUBSEQUENT EVENTS

* * *

Litigation Settlement

The Company has reached settlements with certain defendants in two of the Adversary Litigation proceedings.

On November 18, 1988, the Company received $200,000 in a partial settlement agreement with a defendant in one of the proceedings. In March, 1989, the Company reached partial settlements with certain defendants in both of the cases. All settlement agreements have been approved by the Bankruptcy Court. A portion of the March, 1989, settlement is subject to appeal, however, the Company, in consultations with legal counsel, is of the belief it will be successful in defending this appeal. The Company has recorded a litigation receivable of $21,100,000 at November 15, 1988, as a result of the settlements noted above.

The settlement proceeds of $21,100,000 will be utilized to repay the following liabilities as recorded at December 31, 1988:

| | |
|---|---|
| Accrued professional and other fees, including interest of $180,555 | $5,024,186 |
| Administrative claims, including interest of $136,882 | 3,236,882 |
| Property taxes payable | 345,337 |
| Attorney fees, per contingency agreement | 2,637,500 |
| Note payable to the Pension Benefit Guaranty Corporation | 2,000,000 |
| Reimbursement to the Company of actual costs of litigation and bankruptcy claims | 2,800,754 |
| Distribution per the Plan of Reorganization to the former creditors of Kaiser Steel Corporation | 5,055,341 |
| | $21,100,000 |